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BEFORE THE POSTAL REGULATORY COMMISSION

WASHINGTON, D.C. 20268-0001

Annual Compliance Report, 2011 **Docket No. ACR2011**

COMMENTS OF PITNEY BOWES INC.

James Pierce Myers
Attorney at Law
1420 King Street, Suite 620
Alexandria, Virginia 22306
Telephone: (571) 257-7622
E-Mail: jpm@piercemyers.com

Michael F. Scanlon
K&L GATES LLP
1601 K Street, NW
Washington, DC 20006
Telephone: (202) 778-9000
E-Mail: michael.scanlon@klgates.com

Counsel to PITNEY BOWES INC.

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I. INTRODUCTION

Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments on the Annual Compliance Report for Fiscal Year 2011, filed by the Postal Service on December 29, 2011 (FY2011 ACR). These comments address: (1) the equity and financial implications of the growing disparity in the cost coverage and unit contribution of First-Class Mail Single-Piece and Presort Letters / Cards, (2) the need for more robust workshare regulations, (3) recommendations for a rate design that fully recognizes the value of 5-Digit Automation First-Class Mail Presort Letters, (4) opportunities for deaveraging First-Class Mail Single-Piece Letters, and (5) cost modeling issues in First-Class Mail Flats.

II. DISCUSSION

A. The Growing Disparity in the Cost Coverage and Unit Contribution of First-Class Mail Single-Piece and Presort Letters Must be Addressed

The FY2011 ACR data confirm that First-Class Mail Presort Letters / Cards continue to be much more profitable than Single-Piece First-Class Mail Letters / Cards. Since the Postal Service began reporting costs and revenues by product in the FY2008 ACR the data have shown such a disparity. The concern is that the disparity in cost coverage and unit contribution between these products is growing.

The unit contribution for First-Class Mail Presort Letters / Cards is 23.9 cents. *See* FY2011 ACR at 16. This per piece contribution is now more than six cents greater than the unit contribution of Single-Piece First-Class Mail Letters / Cards, which has fallen to 17.7 cents. *See id*. The 6.1 cent unit contribution differential represents a 0.9 cent increase from the last year. And as the Postal Service observes, "[u]nder the Commission's workshare rules, this difference in unit contribution is almost certain to grow." FY2011 ACR at 50, n.21.

The FY2011 ACR data also confirm that the disparity in the cost coverage between Presort Letters / Cards and Single-Piece Letters / Cards is growing. The cost coverage for Presort Letters / Cards is 298.8 percent, nearly twice the cost coverage of Single-Piece Letters / Cards (161.2 percent). The Postal Service cites to the Commission's observation in last year's ACD regarding "presort customers' concern that the presort cost coverages were too high and could soon be not 'just and reasonable.'" FY2011 ACR at 50, n.21 (citing FY 2010 ACD, at 85). The Postal Service further observes that "the Commission's current interpretation and application of the workshare provision appears to be on a collision course with the clear statutory objective of a just and reasonable rate schedule." FY2011 ACR at 50, n.21.

Pitney Bowes agrees. The bias in the current rate design in favor of Single-Piece Letters / Cards cannot be justified.

Under the CPI price cap the amount of revenue that the Postal Service can collect is constrained, but because the unit contributions from different products differ, not all revenue is equal. This is especially true where, as here, the more profitable product (Presort Letters / Cards) is also more price sensitive. Comments filed by the Direct Marketing Association demonstrate that a more equitable rebalancing of the cost coverage and unit contributions among First-Class Mail products (which would lower Presort Letters / Cards prices) would substantially increase the total contribution from First-Class Mail to the financial benefit of the Postal Service. *See* PRC Dkt. No. ACR2011, DMA Comments (Feb. 3, 2012) at 3-4. This analysis confirms similar work undertaken by DMA in 2009. *See* PRC Dkt. No. RM2009-2, DMA Comments (Sept. 11, 2009) at 5-6.

The Postal Service is correct that the Commission's workshare rules have contributed to the growing disparity in cost coverage and unit contribution between Presort Letters / Cards and

Single-Piece Letters / Cards. However, the Postal Service must share some of the responsibility as well. It has not constrained the price increases on its most profitable product as it should have. For example, the cumulative increase for first ounce Single-Piece letters over the past two pricing adjustments is 2.3 percent, considerably less than the CPI increase over the same period (3.9 percent), and about half the price increase (4.8 and 4.5 percent, respectively), over the same period for first ounce 3-Digit and 5-Digit Automation Letters, which comprised the substantial majority of Presorted Letters / Cards in FY2011. These disproportionate increases represent a missed opportunity on behalf of the Postal Service. Additionally, the selection of an appropriate benchmark (one that accurately reflects the cost avoided by worksharing) and fully passing through avoided costs in workshare discounts would allow the Postal Service to reward and retain its most profitable product.

In light of the financial challenges currently facing it, it is essential that the Postal Service be permitted to rebalance the unit contribution of First-Class Mail letter products to create a more equitable price schedule and improve the Postal Service's financial position.

B. The Commission Should Strengthen Its Workshare Regulations

In the most recent price adjustment, the Postal Service reduced the 5-Digit Automation Letter discount below the prevailing cost avoidance estimate. In contravention of Rule 3010.14(b)(6), which requires the Postal Service to "identify and explain discounts that are set substantially below avoided costs and explain any relationship between discounts that are above and those that are below avoided costs," 39 C.F.R. § 3010.14(b)(6), no explanation was given for the change. The Commission's Order approving the price adjustment cited the concerns raised by Pitney Bowes but unfortunately the Commission chose not to enforce its own rules.

In the same price adjustment, the Postal Service increased the passthrough of the MAADC to AADC Automation Letters discount from 100 percent to 143 percent of the measured costs avoided. The Postal Service made no attempt to justify the increase in the MAADC to AADC discount based upon the statutory exceptions to the workshare discount ceiling as required by Rule 3010.14(b)(6). *See* 39 C.F.R. § 3010.14(b)(6). In response to a Chairman's Information Request asking the Postal Service to "confirm that reducing the discount for First-Class AADC Automation Letters would impede the efficient operations of the Postal Service," the Postal Service repeated verbatim the language from its initial Notice. *See* PRC Dkt. No. R2012-3, Response to CHIR No. 2, Question 2. Again, the Commission chose not to enforce its own rules.

Most troubling, the Postal Service fashioned a reason for setting discounts in excess of the statutory limitation -- excess capacity in its mail processing operations. *See* USPS Notice of Price Adjustment (Oct. 18, 2011) at 35. Numerous parties filed comments raising concerns with the asserted justification of "excess capacity." *See* PR Comments at 10 ("excess capacity" rationale will perpetuate inefficiency and does not constitute a valid exception to section 3622(e)(2)); NAPM Comments at 2-3 (pricing to "excess capacity" is a step in the wrong direction); NPPC Comments at 6 ("excess capacity" rationale sets a troubling precedent, turning away from prices to optimize efficiency); Joint Comments of DMA, MFSA, MMA, NPPC, and PSA at 3 (pricing to "excess capacity" is a form of exclusionary pricing, abandoning commitment to lowest combined mailing costs will accelerate mail volume declines); Pitney Bowes Comments at 2 ("excess capacity" rationale not a long-term solution for an efficient, sustainable postal system). In its Order approving the price adjustments the Commission noted that it "shares the concern that the Postal Service may not have fully considered the price signals implied by pricing to excess capacity. Such actions may have an adverse effect on the efficient operations of the Postal Service." Order No. 987 at 12-13. The Commission further stated that "[m]atters related to this pricing issue may be further reviewed during the ACD process." *Id*. A more forceful response is warranted from the Commission in this ACD.

The comments filed in this proceeding by Dr. John Panzar explain that a shift in the Postal Service's pricing policy that results in setting discounts at less than costs avoided *for any reason* is exclusionary and should be prohibited by the Commission. *See* Comments of John Panzar (Feb. 3, 2012) at 5. As Dr. Panzar observes:

> Deviating from ECP reduces productive efficiency and raises serious competition policy concerns. Reducing discounts below Postal Service avoided costs is a form of exclusionary pricing. This vertical price squeeze would exclude more efficient competitors from performing upstream services. This would have a short-term negative effect on the productive efficiency of the postal sector and a longer-term negative effect of slowing or reversing the shift in value added from the Postal Service to the private sector.

Id. at 5.

Dramatic and sustained mail volume declines have imposed tremendous financial pressure on the Postal Service. To align its operations with reduced workload, the Postal Service must shed its excess capacity, rather than attempting to capture more work by reducing workshare discounts. It is foreseeable that the Postal Service would seek to capture work from the private sector by reducing its discounts, but as discussed by Dr. Panzar, such pricing should not be allowed because it is exclusionary.[1] The Commission must step in to prevent such pricing by strengthening its rules.

The PAEA expressly prohibits workshare discounts above 100 percent of the avoided costs. 39 U.S.C. § 3622(e)(2). The law does not explicitly set a floor for workshare

[1] *See* Panzar Comments at 11-13 (discussing possible incentives for USPS to reduce discounts).

passthroughs. But it also does not prevent the Commission from promoting competition in the marketplace and preventing anti-competitive behavior by requiring that workshare discounts be set (wherever practicable) at 100 percent of avoided costs. In fact, the PAEA gives the Commission the authority under section 3622(a) to do precisely that. The Commission has the authority to establish and, as necessary, revise by regulation the "modern system of regulating rates." 39 U.S.C. § 3622(a).[2] Several of the rate setting objectives and factors under the PAEA (including section 3622(b)(1) on incentives to increase efficiency and section 3622(c)(5) on reflecting the degree of mail preparation) lend direct support to a regulatory requirement that workshare discounts must reflect the full measure of the costs avoided. *See* 39 U.S.C. §§ 3622(b)(1), 3622(c)(5).

Given the stresses currently facing the mailing industry, and given the Postal Service's recent claim that "excess capacity" is a justification for departing from its long-standing practice of pricing to optimize efficiency and access, concepts fundamental to section 3622(e), now is the time for the Commission to strengthen its workshare regulations. Allowing a shift in pricing policy to discourage worksharing and increase work performed by the Postal Service is not a long term solution for the Postal Service. It will lead to higher combined costs for consumers and less innovation and investment by mailers and mail service providers, thus accelerating mail volume declines.

Under the PAEA, only the Commission can exercise the authority to prevent exclusionary pricing and to ensure that postal pricing policies promote economic efficiency and the long-term sustainability of the postal system. In developing regulations implementing the

[2] *See* Panzar Comments at 15 ("I submit that a system of Price Cap regulation that does not guard against exclusionary access pricing does not satisfy [the] directive" to establish a modern system of regulating rates); *see id*. at 16 (citing to recent UK regulatory experience (Ofcom) addressing potential harm from exclusionary pricing through access pricing policy).

new modern system for regulating rates, the Commission acknowledged that it had "used efficient component pricing as a guiding principle in rate design. . . ." *See* Dkt. No. RM2007-1, Order No. 43 (Oct. 29, 2007) at 41, ¶ 2114. The Commission should reaffirm its commitment to efficient component pricing and exercise its explicit statutory authority to revise the modern rate regulations to require that workshare discounts be set (wherever practicable) at 100 percent of avoided costs.

C. Existing Workshare Discounts Do Not Recognize the Full Value of First-Class Mail 5-Digit Automation Letters

As discussed above, the PAEA states that workshare discounts cannot be greater than measured costs avoided, and a modern regulatory policy requires that workshare discounts should not be less than measured costs avoided. For the reasons discussed below, the current workshare discount for First-Class Mail 5-Digit Automation Letters fails to fully recognize the value of 5-Digit mail.

Nearly 50 percent of the volume of all First-Class Mail Automation Letters is 5-Digit Automation; therefore, it is critical that the Postal Service price this product correctly. The Postal Service has adopted a course of pricing this product *incorrectly.* The FY2011 ACR data show that the reported workshare cost avoidance between 3-Digit and 5-Digit Automation Letters decreased, from 2.6 cents to 2.4 cents. As a consequence, the current passthrough now appears to be 100 percent. However, the FY2011 ACR data substantially understate the 5-Digit Automation Letter costs avoided, thereby overstating the passthrough. The reported cost avoidance estimate is inaccurate because they use an obsolete reference point for measuring the pertinent avoided cost and also fail to reflect improvements to the First-Class Mail letter cost models.

Using the correct reference point – AADC Automation Letters, as opposed to 3-Digit Automation Letters – the 5-Digit Automation Letter cost avoidance is 2.8 cents, not 2.4 cents. The resulting passthrough is 86 percent, not 100 percent. *See* USPS-FY11-3, FY11.3. Worksharing Discount Table_Final.xls, "FCM Bulk Letters, Cards," sum of cells G11 ad G12. Moreover, deriving cost avoidance estimates from an improved letter cost model – through the use of a two-part CRA adjustment and more accurate delivery costs – increases the 5-Digit Automation Letter cost avoidance to 3.4 cents, reducing the passthrough further to 70 percent.

1. <u>AADC Automation Letters is the correct reference point for the purpose of estimating the 5-Digit Automation Letter cost avoidance, not 3-Digit Automation Letters</u>

In its most recent price adjustment the Postal Service eliminated the price difference between First-Class Mail AADC and 3-Digit Automation Letters. See Dkt. No. R2012-3, USPS Notice at ___. Pitney Bowes supported this change because the Postal Service likely handles the two presort levels similarly. *See* PRC Dkt. No. R2012-3, PB Comments at 2, n.2; PRC Dkt. No. RM2011-5, PB Comments (Jan. 28, 2011) at 3. The combination of the AADC and 3-Digit Automation Letters workshare tiers, however, requires the adoption of a new reference point for purposes of estimating the 5-Digit Automation Letters cost avoidance. There are two persuasive reasons why the correct reference point is AADC Automation Letters, not 3-Digit Automation Letters.

First, with the combination of the AADC and 3-Digit Automation Letters workshare tiers, the choice now facing mailers is between AADC and 5-Digit preparation. This is because there is no longer a distinct workshare discount (any incentive) for mailers to perform the additional work to presort to 3-Digit (instead of AADC) and there is no requirement that they do so (the 3-

Digit Presort Level is optional, not required for First-Class Mail Automation Letters). *See* DMM 235.6.6b.

Second, the decision to combine the AADC and 3-Digit Automation Letters workshare tiers is predicated on the operational reality that the Postal Service's sorting costs for AADC and 3-Digit Automation Letters are more similar than the Postal Service's cost model estimates. This is because the cost model assumes that AADC letters are first sorted in the Managed Mail Program (MMP) scheme and 3-Digit letters are first sorted in the Incoming SCF/Primary scheme. But this is not the case. The Postal Service likely processes both AADC and 3-Digit Automation Letters in the MMP scheme because it is the workhorse incoming sort scheme at major plants for letters that are not presorted to 5-Digit. As explained in Dkt. No. RM2011-5,

> Entry point assumptions are critical because they give rise to the workshare cost avoidance, e.g., the estimated 3-Digit Automation Letter cost avoidance is the result of the assumption that the first sort received by 3-Digit Automation Letters is an Incoming SCF/Primary sort while the first sort received by AADC Automation Letters is an MMP sort. These entry point assumptions can be seen in the "AUTO AADC Model", "AUTO 3-DIGIT MODEL", and "AUTO 5-DIGIT MODEL" tabs in the USPS-FY10-10 spreadsheets.

PRC Dkt. No. RM2011-5, PB Comments (Jan. 28, 2011) at 3, n.1.

Thus, using AADC Automation Letters as the entry measuring point will eliminate the dependence of the First-Class Mail rate design on the questionable 3-Digit Automation Letter entry point assumption. USPS-FY11-10, USPS-FY11-10 FCM_LTRS.xls, "AUTO AADC MODEL," K8 and "AUTO 3-DIGIT MODEL," Cell K9.[3]

[3] The Incoming SCF/Primary downflow is also based upon an assumption that all pieces not rejected in this operation will proceed next to the incoming secondary operation. USPS-FY11-10, USPS-FY11-10 FCM_LTRS.xls, "AUTO 3-DIGIT MODEL," Cell V41.

2. Improvements to the First-Class Mail Letter Cost Avoidance Model

The First-Class Mail Letter cost avoidance models could be substantially improved in two ways: (1) by appropriately adjusting modeled costs for consistency with CRA costs, and (2) by refining the delivery cost estimates.

a. Appropriately Adjusting Modeled Costs For Consistency With CRA Costs

As Pitney Bowes has explained previously,[4] the method used by the Postal Service to adjust modeled costs for Presort Letters for consistency with Cost and Revenue Analysis (CRA) costs is flawed and should be improved. Specifically, the application of a uniform CRA adjustment to all modeled costs overstates incoming secondary letter sorting costs and understates non-incoming secondary letter sorting costs.

This is because the ratio of CRA-to-modeled costs has consistently (i.e., for the last five years and for both First-Class Mail and Standard Mail) been substantially higher for non-incoming secondary (non-IS) costs (i.e., costs for sorting to destination facility and 5-Digit) than for incoming secondary (IS) costs (i.e., cost for sorting to Carrier Route and delivery point sequence).

Table 1. Ratio of CRA-to-Modeled Costs for Letters

Fiscal Year		First-Class Mail		Standard Mail	
		IS	Non-IS	IS	Non-IS
		[a]	[a]	[b]	[b]
2011	[1]	1.062	1.556	0.889	1.457
2010	[2]	0.984	1.681	0.843	1.396
2009	[2]	0.969	1.611	0.802	1.498
2008	[2]	0.979	1.557	0.773	1.411
2007	[2]	0.986	1.449	0.815	1.308

[4] Most recently, PB addressed this issue in Docket No. RM2010-13, Response of PB to GCA Motion for Leave to File Amended Reply Comments, PB Reply Comments at 16-19, PB Comments at 4-6.

[1][a] PB-2.xls, "2Pt CRA - PRESORT LETTERS SUM"
[1][b] PB-3.xls, "2Pt CRA - PRESORT LETTERS SUM"
[2] Docket No. RM2010-13, PB Reply Comments at 18, Table 5

Use of a uniform adjustment factor for non-IS and IS costs thus results in an insufficient adjustment of non-IS costs for consistency with the CRA, and an over adjustment of IS costs for consistency with the CRA. Most important for the estimation of presort discounts for letters, because non-IS sorting costs are much more affected by worksharing than are IS costs,[5] understating non-IS costs results in understated workshare cost avoidance estimates for letters.

Appropriately adjusting modeled costs – *see* attached Appendices PB-1 through PB-3 – for consistency with the CRA by applying separate adjustments to non-IS and IS costs increases the AADC-5D cost avoidance to 3.3 cents.[6] *See* PB-2.xls, "2Pt CRA – SUMMARY," Sum of cells G15 and G16.

b. Revised Delivery Cost Avoidance Estimates

Between FY 2010 and FY 2011, the delivery cost difference between AADC and 5-Digit Automation Letters decreased by approximately 0.1 cents (from 0.27 cents to 0.18 cents) or approximately one-third. The AADC-5-digit delivery cost avoidances are calculated by subtracting the 5-Digit Automation Letter unit delivery cost from the AADC Automation Letter unit delivery cost. These costs are available on the "Summary" tabs of USPS-FY11-10, USPS-FY11-10 FCM_LTRS.xls and USPS-FY10-10, USPS-FY-10_FCM_PRST_LETTERS_MP

[5] This is because worksharing results in the complete avoidance of some non-incoming secondary sorts (e.g., 5-Digit sortation avoids the Incoming MMP sort that is required for AADC Automation Letters) while all First-Class Mail letters require incoming secondary sortation.

[6] Pitney Bowes does not believe that adopting a two-part CRA adjustment in the First-Class Mail and Standard Mail letter cost models (USPS-FY11-10) would require changes to cost models for flats and parcels. First, Pitney Bowes is not aware of similar disparities in non-IS and IS ratios for other shapes and sees no reason why the disparity in non-IS and IS ratios for letters would imply similar differences for other shapes. Second, unlike letters (where the primary effect of worksharing is on non-IS costs), worksharing has a significant effect on both non-IS and IS costs for flat-shaped mail (e.g., carrier route presort reduces IS costs).

Final-3.). This reduced difference is caused primarily by changes in the DPS percentages produced by the mail processing cost model, *see*, *e.g.*, USPS-FY11-10, USPS-FY11-10 FCM_LTRS.xls, “AADC AUTO COST,” Cell L46), which are inputs into the delivery cost model, *see* USPS-FY11-19, UDCInputs11.xls, “DPS%,” Cells C25-C38 and USPS-FY10-19, UDCInputs10.xls, “DPS%,” Cells C25-C38, to deaverage delivery costs by rate category.[7]

The FY2011 ACR data reveal that the primary driver of the change in DPS percentage is an anomalous decrease in the percentage of letters destinating in 5-Digit ZIP Codes for which sortation to DPS is performed on automation. *Compare* USPS-FY11-10, USPS-FY11-10 FCM_LTRS.xls, “MISC,” Cell E15:E18 with USPS-FY10-10, USPS-FY-10_FCM_PRST_LETTERS_MPFinal.xlsx, “MISC,” Cells E15:E18. This result is highly counterintuitive. One would expect the use of automation to sort to DPS to increase, not decrease, over time. Unless and until this anomaly is adequately explained in the Postal Service’s response to CHIR No. 1, Q2, the 5-Digit delivery cost avoidance should be maintained at the FY2010 level, bringing the total 5-Digit cost avoidance to 3.4 cents.

Accordingly, the Commission should require the Postal Service to use the correct reference point – AADC Automation Letters, as opposed to 3 Digit Automation Letters – for measuring the 5-Digit Automation Letter cost avoidance. Additionally, the Commission should direct the Postal Service to adopt improvements to its cost models to ensure accurate cost avoidance estimates.

[7] This was determined by plugging FY 2010 DPS percentages into the FY 2011 delivery cost model (USPS-FY11-19). Doing so produces a delivery cost avoidance of 0.263 cents, very similar to the 0.270 cent FY 2010 delivery cost avoidance.

C. Opportunities for Deaveraging Further First-Class Mail Single-Piece Letters

The FY2011 ACR data show that the CRA mail processing cost of First-Class Mail Single-Piece Metered Letters decreased between FY 2010 and FY 2011 by nearly 1.4 cents, from 13.611 cents per piece in 2010 to 12.265 cents per piece in 2011. *See* USPS Response to CHIR No. 1 (Jan. 27, 2012), Question 5. In response to a Chairman's Information Request, the Postal Service confirmed that there were no known operational reasons for the decline in the First-Class Mail Single-Piece Metered Letters mail processing estimated unit cost. *See id.*

This change highlights the opportunity for the Postal Service to implement channel-based discounts that incentivize efficient, low-cost, secure Single-Piece metered letters. For over a decade, Pitney Bowes (and more recently others)[8] has advocated in favor of this type of deaveraging as a means of extending the benefits of worksharing to small business and consumer mailers who use efficient, low-cost, secure postage payment evidencing channels (e.g., postage meters, PC Postage, self-service kiosks, etc.). Under the PAEA the Postal Service can implement channel-based discounts. Appropriate pricing signals, in the form of channel-based discounts for mailers who use more efficient distribution and postage payment evidencing channels, could improve the efficiency of the Postal Service, expand the benefits of worksharing to a new cohort of mailers – thus stimulating new mail volumes and promoting an information-rich Single-Piece Mail mailstream.

[8] *See e.g.*, PRC Dkt. No. RM2010-13, PB Comments at 4 (citing historical support); Stamps.com Comments at 5-6; Neopost Comments at 2.

D. Cost Modeling Issues in First-Class Mail Flats

The FY2011 ACR data identify the passthrough of the First-Class Mail Area Distribution Center (ADC) Automation Flat discount as being well in excess of 100 percent – 226.4 percent. *See* FY11.3. Worksharing Discount Table_Final.xls, "FCM Flats." However, this passthrough is primarily the result of a substantially understated cost avoidance estimate. Once the cost model is corrected, the passthrough is close to 100 percent.

Adopting the Postal Service's proposed changes to the flats cost avoidance model, *see* Dkt. No. RM2012-2, Proposal 18, reduces the passthrough to 112 percent – calculated by dividing the current ten-cent discount (down from 12 cents in FY 2011) by the 8.9-cent cost avoidance in USPS-FY11-3, FY11.3Alternate. *See* Worksharing Discount Table_Final.xls, "FCM Flats Prop 18."

As Pitney Bowes has previously explained in its comments on Proposal 18, the Commission should adopt the Outgoing Primary downflow densities proposed by the Postal Service, but should defer acceptance of the Postal Service's proposal to incorporate Flats Sequencing System (FSS) processing costs into the model until it is further refined. *See* PRC Dkt. No. RM2012-2, PB Comments (Dec. 30, 2011). Data filed in this proceeding provide further support for withholding approval of the FSS-related changes at this point. First, the fact that modeled First-Class Mail Presort Flats FSS costs are *more than double* the FSS cost pool costs reported in the CRA confirms that the Postal Service has overmodeled FSS, at least with respect to First-Class Mail – a fact the Postal Service conceded in its response to CHIR No. 1, Q 3, "[i]t appears that First-Class Mail Presort flats are less likely to incur an FSS sort than other flats in the system."

Second, the Postal Service confirmed in response to CHIR No. 1, Q4 that FSS affects delivery costs in addition to mail processing costs. Yet this effect, which would reduce the delivery cost of flats that are processed on FSS, was not modeled. The Postal Service explains the omission by arguing that "[t]he reduced delivery cost is a function of piece destination and is independent of the presort discount or workshare activities." USPS Response to CHIR No. 1, Q4. This statement, however, is directly contradicted by the Postal Service's flats cost model, which, for example, estimates that 5-Digit Automation Flats are 21 percent more likely to be processed on FSS than 3-Digit Automation Flats. *Compare* USPS-FY11-11, USPS-FY11-11 FCM Prsrt Flats Alternate.xls, , "5-DIGIT AUTO COST," Cell C73 with '3-DIGIT AUTO COST," Cell C73.

Adopting the Outgoing Primary downflow densities proposed by the Postal Service in Dkt. No. RM2012-2, while reserving on the proposal to incorporate FSS into the model results in an AADC Automation cost avoidance of 9.3 cents and a passthrough of 107.5 percent. USPS-FY11-11, USPS-FY11-11 FCM Prsrt Flats Alternate.xls with the FSS costing switch (tab "Switches", cell D2) turned off.

III. CONCLUSION

For the reasons discussed above, Pitney Bowes respectfully submits that: (1) the Postal Service should rebalance the unit contribution of First-Class Mail letter products to create a more equitable price schedule and improve its financial position, (2) the Commission should strengthen its workshare regulations to promote efficiency and prevent against exclusionary pricing, (3) the Commission should direct the Postal Service to measure 5-Digit Automation Letter cost avoidance relative to AADC Automation Letters, as opposed to 3-Digit Automation Letters, and should direct the Postal Service to make changes necessary to improve the First-Class Mail letter cost models, (4) the Postal Service should consider additional opportunities to deaverage Single-Piece First-Class Mail letters, and (5) the Commission should adopt the Outgoing Primary downflow densities in the First-Class Mail flat model as proposed by the Postal Service, but should defer acceptance of the Postal Service's proposal to incorporate FSS processing costs into the model until it is further refined.

Pitney Bowes appreciates the Commission's consideration of these comments.

Respectfully submitted:

_____/s/________________

James Pierce Myers
Attorney at Law
1420 King Street, Suite 620
Alexandria, Virginia 22306
Telephone: (571) 257-7622
E-Mail: jpm@piercemyers.com

Michael F. Scanlon
K&L GATES LLP
1601 K Street, NW
Washington, DC 20006
Telephone: (202) 778-9000
E-Mail: michael.scanlon@klgates.com

Counsel to PITNEY BOWES INC.